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UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL COMMUNICATIONS COMMISSION

In the Matter of ) PR Docket No. 94-105

Petition of the People of the )  
State of California and the )  
Public Utilities Commission of )  
the State of California to )  
Retain State Regulatory )  
Authority over Intrastate )  
Cellular Service Rates )

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SUPPLEMENTAL COMMENTS OF THE CELLULAR CARRIERS ASSOCIATION  
OF CALIFORNIA REGARDING THE UNREDACTED INFORMATION SUBMITTED  
BY THE PUBLIC UTILITIES COMMISSION OF THE STATE OF  
CALIFORNIA

Michael B. Day  
Jerome F. Candelaria

WRIGHT & TALISMAN  
Shell Building  
100 Bush Street, Ste 225  
San Francisco, CA 94104  
(415) 781-0701

Attorneys for the  
Cellular Carriers  
Association of California

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TABLE OF CONTENTS

	Page
SUMMARY . . . . .	1
I. INTRODUCTION . . . . .	2
II. THE CPUC DATA PROVIDE COMPELLING EVIDENCE THAT COMPETITION IS BENEFITTING CELLULAR SUBSCRIBERS . . .	5
III. THE CPUC'S ANALYSIS OF EARNINGS AND MARKET POWER IS UNDERMINED BY THE UNREDACTED DATA . . . . .	11
IV. THE UNREDACTED DATA OF CAPACITY UTILIZATION IS MORE CONSISTENT WITH A COMPETITIVE MODEL OF THE CALIFORNIA CELLULAR MARKET THAN THE CPUC'S ILL-CONSIDERED THEORIES . . . . .	15
V. THE ATTORNEY GENERAL MATERIALS ARE PROBATIVE OF NOTHING WHICH SUPPORTS CPUC PETITION . . . . .	18
VI. CONCLUSION . . . . .	21

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OF CALIFORNIA REGARDING THE UNREDACTED INFORMATION SUBMITTED  
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CALIFORNIA**

**SUMMARY**

Pursuant to the terms of the applicable protective order, the Cellular Carriers Association of California (CCAC) has reviewed the confidential data provided under seal to the Federal Communications Commission by the Public Utilities Commission of the State of California (CPUC) in the above-docketed Petition. This information provides no support whatsoever for the position advanced in the petition. Quite the contrary, the unredacted confidential material reveals

additional weaknesses in the CPUC's arguments and supports the conclusions reached by CCAC and its economic consultants, namely, that the CPUC's economic arguments in support of the petition are fatally flawed. Specifically, the information on subscribers and rates for each carriers conclusively proves that customers are obtaining lower and lower rates through the use of discounted rate plans. In addition, the CPUC's arguments that carriers' returns are evidence of market power are undone by evidence that carriers with equivalent market power earn vastly different returns--clearly other forces unrecognized by the CPUC are at work. Finally, neither the CPUC's confused arguments about cell site capacity utilization nor marketing memos obtained from the California Attorney General provide any evidence that the competitive market in California is incapable of providing reasonable rates and service to cellular customers in California.

**I.  
INTRODUCTION**

Pursuant to the Order issued by the Wireless Radio Bureau of the Federal Communications Commission (FCC) on February 9, 1995,<sup>1</sup> (hereinafter referred to as the "Second

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<sup>1</sup> Order, PR Docket Nos. 94-103, 94-105, 94-106, 94-108, DA 95-208, adopted Feb. 9, 1995, released Feb. 9, 1995 (Second Confidentiality Order)

Confidentiality Order") which resolves confidentiality issues raised in the supplemental filings, and issues left outstanding in the First Confidentiality Order<sup>2</sup>, the Cellular Carriers Association of California ("CCAC") hereby submits its supplemental comments regarding the unredacted confidential information submitted by the Public Utilities Commission of the State of California (CPUC) in the above-docketed proceeding in support of its Petition to retain state regulatory authority over intrastate cellular service rates. Representatives of the CCAC have executed declarations agreeing to conform to the terms of the protective order specified by the FCC in its First Confidentiality Order,<sup>3</sup> and have reviewed the confidential information which the CPUC is now providing to parties who have provided such declarations. In this pleading, CCAC provides its comments on the unredacted information and explains its belief that this additional information provides no new support for the CPUC's petition to retain rate regulatory authority. Indeed,

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<sup>2</sup> Order, PR Docket Nos. 94-103, 94-105, 94-106, 94-108, DA 95-111, adopted Jan. 25, 1995, released Jan, 25, 1995 (First Confidentiality Order)

<sup>3</sup> Id.

disclosure of the confidential information at this point significantly supports the arguments of CCAC and other parties who have argued that the cellular industry in California is highly competitive and that this competition is producing reasonable rates.

The supplemental CPUC confidential material consists of several categories of information. This includes market share data as contained in pages 29 to 34 of the unredacted Petition of the People of the State of California and the Public Utilities Commission of the State of California to Retain State Regulatory Authority Over Intrastate Cellular Service Rates (Unredacted Petition) and Appendix E thereto. Appendix F shows after-tax rates of return for a selected group of cellular carriers in large, medium-sized and rural markets within California. Appendix G lists carriers' subscriber growth, revenues and a rate of return calculation. Appendix H calculates cellular carrier revenue, operating expenses, plant investment and operating income on a per subscriber basis. Appendix J addresses individual rate plans for the carriers in the markets selected for analysis by the CPUC, and provides the retail and wholesale rates for each service plan in dollars per minute of use over time. The newly available information from this Appendix includes the percentage of

total cellular subscribers on each carriers' basic rate plan over the 1989-1993 time period, as well as specific rate information regarding discounted rate plans. However, under the terms of the First Confidentiality Order and the protective order adopted therein, the precise number of subscribers on each discounted rate plan is not disclosed, only the ratio of subscribers on basic service plans to the total number of subscribers is revealed. Also included are capacity utilization figures for selected carriers as set forth on pages 50-53 of the Unredacted Petition, and in Appendix M.

The CCAC's review of the confidential information released by the CPUC pursuant to the Second Confidentiality Order demonstrates that the CPUC has revealed further weaknesses in its arguments and has not provided any significant new support for its Petition. In support of this conclusion, CCAC submits as an exhibit to these comments an Affidavit by economists with Charles River Associates who authored a report on the economic arguments made in the original CPUC Petition which was attached to CCAC's original comments in this docket. See Affidavit of Besen, Larner and Murdoch.

## **II.**

**THE CPUC DATA PROVIDE COMPELLING EVIDENCE THAT COMPETITION  
IS BENEFITTING CELLULAR SUBSCRIBERS**

The fundamental issue in this proceeding is whether or not the cellular market in California is sufficiently competitive to protect cellular subscribers from unreasonable rates.<sup>4</sup> To properly answer this question, one must examine the cellular rates subscribers actually pay. The CPUC has artificially limited its inquiry to a discussion of basic service rates, as the CCAC has explained in its opening comments in this docket.<sup>5</sup> The CPUC's two conclusions regarding cellular pricing--basic rates have not changed and there is little variation in basic rates among carriers--both address only basic rate trends. CPUC Unredacted Petition at 34. Even these conclusions are undercut by the CPUC's own admission that basic cellular rates have in fact declined \_\_\_\_ in real terms over the 1989-1993 time period. CPUC Unredacted Petition at 34. Given the decidedly upward trends in rates

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<sup>4</sup> Second Report and Order in the Matter of Implementation of Sections 3n and 332 of the Communications Act, 74 RR 2d (P&F) 835 adopted February 3, 1994 ("Second Report and Order").

<sup>5</sup> See Response Of The Cellular Carriers Association Of California Opposing The Petition Of The Public Utilities Commission of The State Of California To Retain State Regulatory Authority Over Interstate Cellular Service Rates dated September 19, 1994 ("CCAC Comments") at 30.



for basic telephone service, natural gas service and electric service, which are also regulated by the CPUC, a \_\_\_ reduction in real rates is reason to stand up and cheer, not a reason to retreat to an even more draconian form of command and control regulation.<sup>6</sup>

More importantly, the CPUC's unredacted Appendix J confirms that the vast majority of cellular subscribers have migrated from basic rate plans to discounted rate plans. See Affidavit of Besen, Lerner and Murdoch at 4-5. By 1993 the percentage of total subscribers on basic rate plans of

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<sup>6</sup> In its Decision 94-08-022 which authorized the filing of the instant Petition, the CPUC specifically discussed the possibility of further proceedings to require rate rollbacks for cellular carriers. These rate rollbacks were intended to correct for what the CPUC perceived as excessive return earned by cellular carriers, and the CPUC's opinion of a proper return was apparently to be the new standard for setting cellular service rates.

carriers studied by the CPUC had fallen to the levels listed below:

**Table 1**

**Cellular Subscribers, 1993**

Company	# Retail Customers (Basic)	# Retail Customers (Total)	Basic as % of Total Customers
Los Angeles Cellular Telephone Company	_____	_____	_____
Los Angeles SMSA LP	_____	_____	_____
Bay Area Cellular Telephone Company	_____	_____	_____
GTE Mobilnet LP (SF Bay Area)	_____	_____	_____
US West (San Diego)	_____	_____	_____
AirTouch Cellular (San Diego)	_____	_____	_____
Sacramento Cellular Telephone Company	_____	_____	_____
Sacramento Valley LP	_____	_____	_____
Fresno Cellular Telephone Company	_____	_____	_____
Fresno MSA Limited Partnership	_____	_____	_____
Santa Barbara Cellular Systems, Ltd.	_____	_____	_____
GTE Mobilnet Santa Barbara LP	_____	_____	_____
Cal. RSA #2	_____	_____	_____
Modoc RSA LP	_____	_____	_____
Century El Centro Cellular Corp.	_____	_____	_____
Contel Cellular	_____	_____	_____
All 16 co.'s	_____	_____	_____
1st 6 co.'s: LA,SF,SD	_____	_____	_____
Source: CPUC Unredacted Petition, Appendix J			

In all of the major markets studied by the CPUC, basic rate service is selected by a rapidly shrinking minority of subscribers. Only in the anomalous situation of Sacramento Valley LP (whose basic service is priced well below its Sacramento competitor) and that of the small rural cellular operators does the number of customers on basic service still

exceed \_\_\_\_ of the subscriber base. It should also be recalled that in absolute numbers, most cellular subscribers are found in the major markets in California.<sup>7</sup> Thus, the unredacted data strongly confirms the conclusion in CCAC's own study of California cellular rates that the overwhelming majority of California cellular subscribers receive discounted rates.<sup>8</sup>

This makes even more damaging the failure of the CPUC to undertake any quantitative analysis of discounted rate trends within California. The CPUC's discussion of discounted rates is limited to handwringing about the difficulty of accounting for non-rate terms and conditions of discounted rate plans. CPUC Unredacted Petition at 34-37. If the CPUC is unable to undertake such a study to support a Petition which is so fundamental to its jurisdiction over cellular rates, perhaps this is an indication that it should not undertake to attempt to regulate the everchanging prices for cellular service in the competitive California market.

In fact, it appears that the CPUC has made an affirmative

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<sup>7</sup> Of the \_\_\_\_\_ retail and wholesale cellular subscribers in the cellular systems selected by the CPUC for rate analysis, over \_\_\_\_ reside in the Los Angeles, San Francisco Bay Area and San Diego regions alone. The average percentage of basic rate subscribers among the six carriers serving these areas is only \_\_\_\_\_, well below the statewide average of \_\_\_\_ calculated by the CPUC.

<sup>8</sup> CCAC Comments at 31.

decision to not place before the FCC a comparative analysis of discounted cellular rates. Such comparisons can be made in a number of different ways, including the optimal rate plan analysis contained in the CCAC rate study, which was presented to the CPUC some four months prior to the CPUC's Petition to the FCC. Rather than making some attempt to study discounted rates quantitatively, the CPUC advances a straw man, saying that "to make any claim on the effect of discount plans on rates" actual customer bills would have to be audited at random. CPUC Unredacted Petition at 43, fn 24. The CPUC had the authority to obtain the information to undertake such an analysis, and indeed requested supplemental data from the carriers prior to filing the instant Petition.

In spite of that investigative ability, the CPUC is apparently simply unwilling to examine the decreases in discounted rates, limiting its comments to an offhand concession that "Discount plans offer *modest* rate relief to *some consumers*." (Emphasis added.) CPUC Unredacted Petition at 43. The unredacted data submitted by the CPUC makes it clear that "some customers" includes over \_\_\_ of the customers in major cellular markets in California. See Table 1 above. CCAC contends that the unredacted data provides significant evidence of competition in the California market. Even more importantly, CCAC contends that the level of competition in

the California market, having demonstrated its ability to sustain a trend of decreasing rates in the face of enormous customer growth and system expansion, has proven that it can ensure that cellular customers pay reasonable rates.

III.  
**THE CPUC'S ANALYSIS OF EARNINGS AND MARKET POWER IS  
UNDERMINED BY THE UNREDACTED DATA**

The subscriber growth rates and after-tax rates of return calculated by the CPUC using California cellular carriers' annual reports are contained in Appendix F of the CPUC Petition. The CPUC attempts to use this data to support its central hypothesis--that cellular carriers wield market power which allows them to earn excessive returns. In particular, the CPUC offers the subscriber growth data to distinguish rate of return data which conflicts with its hypothesis, such as in Santa Barbara. Unredacted Petition at 48.

Both the CPUC's hypothesis and its effort to explain incongruities in the data are failures. CCAC has previously demonstrated that basic principles of economics argue against attempting to use accounting rates of return to determine the existence or absence of market power.<sup>9</sup> Moreover, the CPUC has presented no logical or consistent framework for defining

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<sup>9</sup> CCAC Comments at 16, Affidavit of Besen, Larner and Murdoch at 2.

a "reasonable rate of return" in a competitive, technology-driven, and rapidly expanding industry such as cellular telecommunications. Without expressly stating its frame of reference, the CPUC is implicitly comparing cellular returns against its traditional measure of returns for energy utilities--which bear none of the characteristics listed above. However, even by its own terms, the CPUC argument is defeated by the unredacted data.

Over the five years studied by the CPUC (1989-1993), the major market cellular carriers (located in Los Angeles, San Francisco, and San Diego) earned returns which the CPUC calculated to average \_\_\_\_\_. However, the medium and small market cellular carriers earned far, far lower returns over the same time, and in many cases most of the medium or small market carriers sustained substantial losses. Over these same five years, the medium market carriers studied by the CPUC averaged a return of only \_\_\_\_\_ and small market carriers averaged a decidedly disappointing \_\_\_\_\_.

The CPUC's hypothesis is undone by the fact that the higher returns in the major markets cannot be easily explained by market power. Exactly the same duopoly market structure exists in the small and medium markets (and in some cases the rural carriers would be expected to exercise even greater market power as they were effectively monopolists for portions

of this period in the absence of a competing carrier). Market concentration calculations would be equivalent for large, medium, and small carriers, and each such carrier should have had equivalent market power. Yet we see vastly different returns for the large and small carriers. This leads to the inescapable conclusion that forces other than market power account for the differences in returns which are seen. Likely candidates are the greater demand for cellular service in large urban areas, and greater economies of scale in such markets. Affidavit of Besen, Lerner and Murdoch at 3.

The CPUC makes no effort to address the effects of different demand in different markets or the effect of economies of scale. Nor does the CPUC provide any explanation for the discrepancies in carriers' returns, other than completely unsubstantiated speculation about administrative and general costs in the U.S. West system and an equally unsupported anecdote about the lengthy "maturation" of the market in Santa Barbara. Unredacted Petition at 47, 48. Absent additional evidence, these offhand remarks do nothing to explain why carriers with equivalent market power produced earnings in one market which were vastly different than in another market. Nor do they, of course, offer any explanation for the low or negative returns experienced by other medium and small market carriers. Yet an analytical observer would

not expect to find the relationship predicted by the CPUC.

CCAC has already devoted extensive discussion in its comments to the forces which actually produced the returns which have been recorded, including the fact that returns calculated in the manner used by the CPUC grossly overestimate returns by failing to take any account of the value of cellular spectrum licensed to carriers or the substantial capital investment in the cellular spectrum made by a number of carriers.<sup>10</sup> In addition, as referenced above, both CCAC's Comments and the accompanying Charles River Associates Report explained that accounting rates of return cannot be used to detect the presence or absence of monopoly profits or the abuse of market power. CCAC Comments, Appendix A at 21, 22. Rather than repeating these arguments at length, CCAC simply wishes to point out that the CPUC's assertion that the exercise of market power by cellular carriers has produced excessive returns is contradicted by its very own rate of return calculations, which conclusively demonstrate that carriers with identical market power earned widely different returns.

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<sup>10</sup> CCAC Comments at 16, Affidavit of Besen, Larner and Murdoch at 3.



IV.

**THE UNREDACTED DATA OF CAPACITY UTILIZATION IS MORE  
CONSISTENT WITH A COMPETITIVE MODEL OF THE CALIFORNIA  
CELLULAR MARKET THAN THE CPUC'S ILL-CONSIDERED THEORIES**

The unredacted data on capacity utilization provided in Appendix M of the CPUC Petition conforms to precisely the type of behavior predicted by CCAC's economic consultants prior to the release of the confidential information. In its initial Comments on the CPUC Petition, the Charles River Associates Report discussed at length the need for intensive investment by cellular carriers in new capacity, and the key characteristic that a prudent capital investment strategy will naturally produce "lumpy" patterns of investment in cellular capacity.<sup>11</sup> It is simply inefficient for a carrier to always build exactly enough capacity to ensure no excess capacity exists. In addition, carriers may legitimately construct additional capacity to ensure high quality transmission and a high call completion ratio.

The data produced by the CPUC in the unredacted petition reveals exactly this type of "lumpy" investment pattern. Affidavit of Besen, Larner and Murdoch at 6. For every single one of the carriers studied, the percentage of cell sites classified as having a high, medium or low level of utilization varies substantially year after year, as carriers

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<sup>11</sup> CCAC Comments, Appendix A ("CCAC Report" at 28.)

make discrete investments in new capacity. The figures for Los Angeles Cellular Telephone Company are typical of the patterns to be found in this data. The percentage of high usage cell sites varies from \_\_\_ to \_\_\_, the medium usage sites vary from \_\_\_ to \_\_\_ and the low level usage sites range all the way from \_\_\_ to \_\_\_. Unredacted Petition, Appendix M, at M-1. For carrier after carrier, the percentages in each category vary up and down, frequently by \_\_\_ or more in a single year. This is evidence of "lumpy" investments in capacity in its most obvious form.

It must also be remembered that each of the major market carriers whose capacity data is depicted in Appendix M has sustained truly enormous customer growth in recent years--in almost every case one finds customer growth in excess of \_\_\_ per year. Unredacted Petition, Appendix J, at J-1, 4, 7, 11, 16, 20.

A useful example demonstrates the impact of such rapid growth. By 1992, the Airtouch affiliate in San Diego had reduced the percentage of its cell sectors classified as having high usage to only \_\_\_, after making a substantial investment in additional cellular capacity. Yet after sustaining its second year of record customer growth in the last three years (1991-\_\_\_, 1992-\_\_\_, 1993-\_\_\_) the percentage

of high volume cell sectors was back up to \_\_\_\_\_. Unredacted Petition, Appendix M at M-3.

Such phenomenal growth can get the best of even aggressive capital investment programs. It also validates the efforts of carriers to maintain some underutilized capacity to help absorb the onslaught of new customer growth. A carrier who intentionally tried to match capacity with customer growth precisely would walk a very risky tightrope, indeed.

The most egregious failing of the CPUC's discussion of capacity utilization is its inability to articulate what it believes a rational pattern of capital investment in capacity would look like. The capacity utilization data contained in Appendix M is consistent with the model of investment in capacity additions advanced by Charles River Associates in the Report attached to CCAC's Comments.<sup>12</sup> The data also explains why no carrier would dare allow their reserve of unused capacity to shrink to the minuscule level the CPUC apparently believes is reasonable. The CPUC has failed to establish a relationship between cell sector utilization and prices which supports its theories.

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<sup>12</sup> CCAC Comments, Appendix A at 29-30.

V.  
**THE ATTORNEY GENERAL MATERIALS ARE PROBATIVE OF NOTHING  
WHICH SUPPORTS CPUC PETITION**

CCAC has also examined the confidential material obtained by the CPUC from the files of the Attorney General of California. The CPUC has already conceded that these three excerpts from carriers' marketing documents do not allege any anti-competitive behavior. See Petition for Clarification With Corresponding Extension Of Time, filed January 30, 1995, at 4. The FCC has ordered that these excerpts shall only be accepted into the record for the purpose proffered by the CPUC, namely to describe the marketing practices of the carriers, and not for any other purpose. See Second Confidentiality Order at 14.

In fact, the confidential excerpts from the Attorney General's files (AG excerpts) do not offer any support for the CPUC's conclusion that state regulation is necessary to protect consumers. The AG excerpt on page 45 of the Unredacted Petition simply describes \_\_\_\_\_  
\_\_\_\_\_. As discussed at length in CCAC 's Comments, these discounts have affirmatively benefitted customers. The fact that such discounts \_\_\_\_\_  
in no way diminishes their benefit to consumers. The

competition in California is such that such discounted plans continue to serve more and more customers every year. See Unredacted Petition, Appendix J. \_\_\_\_\_, they are a fact of life in the California market and they help reduce rates.

Another of the AG excerpts addresses \_\_\_\_\_. This marketing goal of cellular carriers, in and of itself, cannot be criticized. \_\_\_\_\_ Lower costs for administering cellular service provide carriers with the ability to lower rates further. \_\_\_\_\_ are considered valid means of marketing commercial and industrial gas or electric service, a wide variety of telecommunications services for small and large businesses, insurance, newspapers, or even health club memberships. There is nothing reprehensible in the goal \_\_\_\_\_. In fact, offering more attractive rates to customers for such commitments is precisely the type of competitive behavior the CPUC should be encouraging, not castigating.

The excerpts from the Attorney General's files simply reflect the reality of marketing practices within the cellular industry today. The rate and subscriber data provided in the

Unredacted Petition prove that cellular carrier marketing is working for the benefit of consumers by providing increasing opportunities for discounts--which customers are eagerly accepting. This information does not in any way support the CPUC's conclusion that rate regulation is needed. It is ironic indeed for the CPUC to present these excerpts as if they were evidence of unfair practices when in fact the CPUC has expressly condoned the very practice discussed in the marketing memos: \_\_\_\_\_

\_\_\_\_\_. How can a marketing practice approved by the regulator be evidence of a failure of the market to protect consumers? The CPUC makes no attempt to explain this conundrum.

## VI. CONCLUSION

The Cellular Carriers Association of California believes more strongly than ever that the Petition of the CPUC is unfounded and should be denied by the FCC at its earliest opportunity. The CPUC's arguments about excessive rates are clearly disproven by its own appendices which portray a market in which the competition for customers produces ever increasing numbers of discounted rate plans which customers are embracing voluntarily. Even the CPUC

reluctantly concedes that rates have decreased \_\_\_\_ in real terms over the period covered by their data. This is the central fact in the case. It is not possible to conclude that the California cellular market is incapable of ensuring reasonable rates for consumers when competition is generating consistent downward pressure on rates, offering customers more attractive options each day. On the contrary, this is convincing evidence of exactly the type of competitive behavior the FCC seeks to foster in the wireless industry.

The arguments advanced by the CPUC with respect to carriers' earnings, market power, and capacity utilization are equally unavailing. CCAC's economic consultants at Charles River Associates have concluded that nothing in the unredacted data provides any reason to alter their original conclusions that the CPUC's economic arguments are "seriously flawed" and provided no basis to conclude, as the CPUC had, that the cellular market in California is uncompetitive and rates are unreasonably high. Affidavit of Besen, Larner and Murdoch at 1-2.

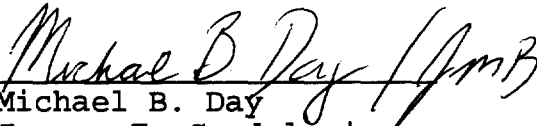
With a single additional round of reply comments, the record in this docket will be complete. CCAC urges the Commission to expeditiously apply the standard announced in the Second Report and Order to the record in this proceeding

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and conclude that the CPUC has not met its burden of proof. The record is replete with evidence that the cellular market in California is both highly competitive and more than capable of continuing to provide customers with reasonable rates, as evidenced by the ongoing trend of rate reductions and new competitive service offerings.

Respectfully submitted,

WRIGHT & TALISMAN

By   
Michael B. Day  
Jerome F. Candelaria

100 Bush Street, Suite 225  
San Francisco, CA 94104  
(415) 781-0701

Attorneys for Cellular Carriers  
Association of California

Dated: February 15, 1995



**Affidavit of  
Stanley M. Besen, Robert J. Larner, and E. Jane Murdoch**

1. We are economists with Charles River Associates ("CRA"). On September 19, 1994, we submitted to the Federal Communications Commission ("FCC") a report ("CRA Report"<sup>1</sup>) commenting on the Petition filed in this matter on August 8, 1994, by the Public Utilities Commission of the State of California ("CPUC" or "Commission") to retain regulatory authority over rates for cellular service within California.<sup>2</sup> Our resumes are attached to this affidavit.

2. In its Petition, the CPUC concluded from its analysis of evidence obtained in connection with its investigation into the wireless industry in California that ".... cellular service in California is not currently competitive, and that market forces are not yet adequate to protect California customers from paying unjust and unreasonable rates for such service."<sup>3</sup> In our report, we showed that the analysis in the CPUC's Petition and in its related Decision<sup>4</sup> was seriously flawed. We also showed that, once the flaws in its analysis were corrected, the CPUC lacked a sufficient basis for its conclusion that cellular service in California is uncompetitive and that rates in the state are unreasonably high.

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<sup>1</sup> "Report of Charles River Associates on the Petition of the People of the State of California and the Public Utilities Commission of the State of California to Retain State Regulatory Authority over Intrastate Cellular Service Rates," September 19, 1994.

<sup>2</sup> FCC GN Docket No. 93-252, "Petition of the People of the State of California and the Public Utilities Commission of the State of California to Retain State Regulatory Authority over Intrastate Cellular Service Rates," August 8, 1994 ("Petition").

<sup>3</sup> Petition, p. I.

<sup>4</sup> Decision 94-08-022, The Public Utilities Commission of the State of California, "Investigation of the Commission's Own Motion into Mobile Telephone Service and Wireless Communications," August 3, 1994, ("Decision").